The Canada-U.S. Free Trade Agreement

The Guide To Strategic Planning Under Free Trade

Rules of Origin Annex

Province of British Columbia

Rules of Origin – Annex

PART ONE

You have ALREADY determined that your business could be affected by the rules of origin under the FTA. This complex set of rules may be somewhat confusing at first. It is recommended that you read this annex in its entirety before you attempt to follow the directions and work steps.

In order to determine the applicable rules of origin for your goods, refer to the Catalogue Tariff Reductions you have already completed.

Make a note beside each of the items listed as to whether they are an input or end product. Mark all inputs with the letter "I" and all end products with the letter "E".

Refer to all items that you marked with an "E" and to the applicable tariff classification number. The first two numbers in each classification number refer to a chapter of the tariff classification system.

Refer to Part Two of this annex which contains the tariff classification rules. These rules will allow you to determine whether or not your end product is entitled to treatment in accordance with the FTA. Turn to the page in Part Two of the annex which relates to the appropriate chapter of the goods you marked with an "E".

Look through the relevant paragraphs of the Chapter pertaining to your good and highlight each paragraph that contains a potential reference to your good. (Note: in order to do this you may have to refer to more than the first two numbers of the tariff classification of your good, as there may be more than one rule which could apply to your good.)

Each of the paragraphs of the rules sets out the criteria that will result in a good being deemed to originate from within Canada or the U.S. and are known as the "rules of origin".

There are six categories of rules:

Category	Rule
1.	Rules relating to chapter changes.
2.	Rules relating to heading changes.
3.	Rules relating to subheading changes.
4.	Rules relating to category 1, 2, or 3 with specific exclusions.
5.	Rules relating to category 1, 2, or 3 with a reference to the "direct cost of processing" criteria.
6.	Rules containing specific references other than the 5 listed above.

Explanation

Part A

Each section of the Rules of Origin is laid out with general rules appearing first, followed by specific rules. It is important to remember one general overriding principle:

A Specific Rule Will Take Precedence Over A General Rule

For example:

"A change to Chapter 15 from any other chapter".

This general rule will not apply if there is a more specific rule withing the section pertaining to the good you are concerned with.

"A change to heading 1516 to any other heading".

This specific rule would take precedence over the more general rule relating to chapter changes.

Part B Explanation of Rules Categories

Category 1 — Rules relating to chapter changes

The first two digits in a tariff classification number refer to a chapter. For example, in commodity classification 1507.09, the 15 refers to a chapter.

Example of rule category:

"A change from one chapter to another"

This rule would mean (in absence of a more specific rule to the contrary) that if your processing of an input good (or goods), transformed that input good in its exported finished state, to a different tariff classification chapter, then your finished good would be considered to originate from Canada.

Category 2 — Rules relating to heading changes

(ii)The third and fourth digits in a tariff classification number refer to a heading. For example, in commodity classification 1507.90, the number .07 is a reference to a heading.

Example of a rule category:

"A change to heading 1516 from any other heading"

This rule would mean (in absence of a more specific rule to the contrary) that if your processing of an input good (or goods) transformed that input good in its exported finished good state to a heading 1516, from any other tariff classification heading, then that finished good would be considered to originate from Canada.

Category 3 — Rules relating to subheadings

The fifth and sixth digits in a tariff classification number refer to a subheading. For example, in commodity classification 1507.**90**, the number .90 is a reference to a subheading.

Example of rule category:

" A change in subheading 1519.20 from any other subheading"

This rule would mean (in absence of a more specific rule to the contrary) that if your processing of an input good (or goods) transformed that input good in its exported finished good state, to a subheading 1519.20, from any other tariff classification subheading, then that finished good would be considered to originate from Canada.

Category 4 — Rules relating to category 1, 2, or 3 with specific exclusions

Example of rule category:

"A change to heading 7217 from any other heading except headings 7213, 7214, 7215"

This rule would mean (in absence of a more specific rule to the contrary) that if your processing of an input good (or goods) transformed that input good in its exported finished good state, to heading 7217, from any other tariff classification heading, except from headings 7213, 7214 or 7215, then that finished good would be considered to originate from Canada.

Category 5 — Rules relating to category 1, 2 or 3 with a reference to the "direct cost of processing" criteria

Example of rule category:

"A change to headings 7801–7901 from headings of other chapters, provided, that the value of materials originating in the territory of either Party or both Parties, plus the direct cost of processing performed in the territory of either Party or both Parties, constitute not less than 50 percent of the value of the goods when exported to the territory of the other Party."

This rule is known as a direct cost of processing rule. In general terms a good will qualify for treatment under the FTA if 50% or more of the value of the good is added within the territory of Canada or the U.S. Part Two of this Annex provide the definitions which facilitate an analysis of the calculations involved in "direct cost of processing" and "value of materials originating in the territory of either party". You will have to refer to these pages if your good is subject to a Category 5 rule.

Category 6 — Rules containing specific references other than the 5 previously listed categories.

Example of rule category:

"A change to United States tariff item 8111.00.60 from any other United States tariff item. This rule applies only to goods originating in the territory of Canada and imported into the territory of the United States."

Rules in category 6 are specific in nature and will vary throughout the Rules of Origin.

INSTRUCTION:

Refer to the paragraphs that you have highlighted in Part 2 of this Annex.

Identify the Paragraphs Containing the Rule of Origin that is Applicable to Your Finished Good.

Determine the effect of the rule by referencing the items you marked with an "I" on your Catalogue of Tariff Reductions and the change of classification occurring to those goods you marked with an "E".

The analysis under this section will vary from company to company. Those companies with products falling under categories 1, 2, 3 or 4, will have a basic and straight forward analysis to complete. Those companies with products falling within category 5 or 6 will have a more complex analysis to complete. Your analysis should provide you with an answer to the following question:

Do my finished products originate from Canada according to the rules of origin of the FTA?

If you answered YES, your finished product originates in Canada and can therefore benefit from FTA treatment.

If you answered NO, consider the following:

Would it be possible to source more of your input products domestically or from the U.S.?

What would the cost of making such a sourcing change be in terms of quality? In terms of price? In terms of reliability of supply?

Will sourcing from the U.S. become more practical (in price terms) once tariffs are eliminated?

What other changes could you make in your business practices to ensure your products are classified as Canadian in origin? For example, could you alter some of the techniques in production so as to raise your direct cost of processing which could be offset by cost savings elsewhere?

What is the cost of not changing your sourcing or other business practices to take advantage of the FTA? Will failure to make such changes render you incapable of competing in the U.S. market?

Conclusion

The rules of origin under free trade are quite complex. The rules are also an integral part of the FTA and cannot be overlooked by affected businesses.

If you have reached this point in the analysis, your business is likely one of those which is affected by the rules. Your answers to the questions above should help you decide what steps are appropriate for your business to take in response to the rules of origin.

As you continue with the Guide to Strategic Planning Under Free Trade, keep in mind your analysis pertaining to the rules of origin.

Rules of Origin – Annex

PART TWO

Rules

Section I
Live Animals; Animal Products
(Ch. 1-5)

A change from one chapter to another; no changes within chapters.

Section II
Vegetable Products
(Ch. 6-14)

1. A change from one chapter to another; no changes within chapters except that agricultural and horticultural goods grown in the territory of a Party shall be treated as originating in the territory of that Party even if grown from seed or bulbs imported from a third country.

2. A change to subheadings 0901.12-0901.40 from any other subheadings, including another subheading within that group.

Section III
Animal or Vegetable Fats and Their Cleavage Products; Prepared Edible Fats; Animal or Vegetable Waxes
(Ch. 15)

1. A change to Chapter 15 from any other chapter.

2. A change to any of the following subheadings from any other subheading: 1507.90, 1508.90, 1511.90, 1512.19, 1512.29, 1513.19, 1513.29, 1514.90, 1515.19, 1515.29.

3. A change to heading 1516 from any other heading.

4. A change to heading 1517 from any other heading.

5. A change to headings 1519-1520 from any other heading outside that group.

6. A change to subheading 1519.19 from any other subheading.

7. A change to subheading 1519.20 from any other subheading.

8. A change to subheading 1520.90 from any other subheading.

Section IV
Prepared Foodstuffs; Beverages, Spirits, and Vinegar; Tobacco and Manufactured Tobacco Substitutes
(Ch. 16-24)

1. A change from one chapter to another, except for goods of Chapter 20 subject to rule 5.

2. A change to heading 1704 from any other heading.

3. A change to heading 1806 from any other heading.

4. A change to subheading 1806.31 or 1806.90 from any other subheading.

5. Fruit, nut, and vegetable preparations of Chapter 20 that have been prepared or preserved merely by freezing, by packing (including canning) in water, brine, or in natural juices, or by roasting, either dry or in oil (including processing incidental to freezing, packing, or roasting), shall be treated as a good of the country in which the fresh good was produced.

6. A change to subheading 2009.90 from any other subheading; provided, that neither a single juice ingredient, nor juice ingredients from a single third country, constitutes in single-strength form more than 60 percent by volume of the product.

7. A change to headings 2207-2209 from any other heading outside that group.

8. A change to heading 2309 from any other heading.

9. A change to headings 2402-2403 (except 2403.91) from any other heading outside that group.

Section V
Mineral Products
(Ch. 25-27)

1. A change from one chapter to another.

2. A change to headings 2710-2715 from any other heading outside that group.

3. A change to heading 2716 from any other heading.

Section VI
Products of the Chemical or Allied Industries
(Ch. 28-38)

1. A change to Chapters 28-38 from any chapter outside that group.

2. A change to any subheading of Chapters 28-38 from any other subheading within those chapters; provided, except for the other rules in this section, that the value of materials originating in the territory of either Party or both Parties plus the direct cost of processing performed in the territory of either Party or both Parties constitute not less than 50 percent of the value of the goods when exported to the territory of the other Party.

3. A change to a heading of Chapter 30 from any other heading, including other headings within that chapter, except a change to heading 3004 from heading 3003.

4. A change to Chapter 31 from any other chapter.

5. A change to headings 3208-3215 from any other heading outside that group.

6. A change to Chapter 33 from any other chapter.

7. A change to heading 3304-3307 from any heading outside that group.

8. A change to a heading of Chapter 34 from any other heading, including another heading within that chapter.

9. A change to subheadings 3402.20 -3402.90 from any other subheading outside that group.

10. A change to a heading of Chapter 35 from any other heading, including another heading within that chapter.

11. A change to a heading of Chapter 36 from any other heading, including another heading within that chapter.

12. A change to Chapter 37 from any other chapter.

13. A change to heading 3704 from any other heading.

14. A change to headings 3705-3706 from any other heading outside that group.

15. A change to heading 3808 from any other heading; provided, that the value of materials originating in the territory of either Party or both Parties plus the direct cost of processing performed in the territory of either Party or both Parties constitute not less than 50 percent of the value of the goods when exported to the territory of the other Party, or, in the case of goods which contain more than one active ingredient, not less than 70 percent of the value of the goods when exported to the territory of the other Party. Any materials that are eligible for duty-free treatment in both Parties on a most-favoured-nation basis, or any materials imported into the territory of either Party which, if imported into the territory of the United States of America, would be free of duty under a trade agreement that is not subject to a competitive need limitation, shall be treated as materials originating in the territory of a Party.

Section VII
Plastics and Articles Thereof; Rubber and Articles Thereof (Ch. 39-40)

1. A change to any heading of Chapter 39 from any other heading, including another heading within that chapter; provided, that the value of materials originating in the territory of either Party or both Parties plus the direct cost of processing performed in the territory of either Party or both Parties constitute not less than 50 percent of the value of the goods when exported to the territory of the other Party.

2. A change to Chapter 40 from any other chapter.

3. A change to any heading of Chapter 40 from any other heading within that chapter; provided, except for the rules below listed in this section, that the value of materials originating in the territory of either Party or both Parties plus the direct cost of processing performed in the territory of either Party or both Parties constitute not less than 50

percent of the value of the goods when exported to the territory of the other Party.

4. A change to headings 4007-4008 from any other heading outside that group.

5. A change to headings 4009-4017 from any other heading outside that group.

6. A change to subheading 4012.10 from any other subheading.

Section VIII
Raw Hides and Skins, Leather, Furskins and Articles Thereof; Saddlery and Harness, Travel Goods, Handbags, and Similar Containers; Articles of Animal Gut (Other Than Silkworm Gut)
(Ch. 41-43)

1. A change from one chapter to another.

2. A change to headings 4104-4111 from any other heading outside that group.

3. A change to heading 4302 from any other heading.

4. A change to headings 4303-4304 from any other heading outside that group.

Section IX
Wood and Articles of Wood; Wood Charcoal; Cork and Materials of Cork; Manufactures of Straw, of Esparto or of Other Plaiting Materials; Basketware and Wickerware
(Ch. 44-46)

1. A change from one chapter to another.

2. A change between headings in Chapter 44.

3. A change to any of the following United States tariff items from any other United States tariff item: 4412.11.50, 4412.12.50, 4412.19.50, 4412.29.50, or 4412.99.90. This rule applies only to goods originating in the territory of Canada and imported into the territory of the United States of America.

4. A change to headings 4503-4504 from any other heading outside that group.

5. A change to heading 4602 from any other heading.

Section X
Pulp of Wood or of other Fibrous Cellulosic Material; Waste and Scrap of Paper or Paperboard; Paper and Paperboard and Articles Thereof
(Ch. 47-49)

1. A change from one chapter to another.

2. A change to heading 4808-4809 from any other heading outside that group.

3. A change to headings 4814-4823 from any other heading outside that group except a change from heading 4809 to heading 4816.

Section XI
Textiles and Textile Articles
(Ch. 50-63)

Silk

1. A change to headings 5004-5006 from any heading outside that group.

2. A change to heading 5007 from any other heading.

Wool

3. A change to headings 5106-5113 from any heading outside that group.

Cotton

4. A change to headings 5204-5212 from any heading outside that group.

Flax, Jute, Sisal, Paper Yarn

5. A change to headings 5306-5311 from any heading outside that group.

Man-Made Filaments

6. A change to any heading of Chapter 54 from any other chapter.

Man-Made Staple Fibers

7. A change to headings 5501-5507 from any other chapter.

8. A change to headings 5508-5516 from any heading outside that group.

Wadding, Felt, Etc.

9. A change to any heading of Chapter 56 from any heading outside that chapter other than headings 5106-5113, 5204-5212, 5306-5311, or headings of Chapters 54 and 55.

Carpets and Textile Floor, Etc.

10. A change to any heading of Chapter 57 from any heading outside that chapter other than headings 5106-5113, 5204-5212, 5306-5309, 5311, or 5508-5516.

Special Woven Fabrics, Etc.

11. A change to any heading of Chapter 58 from any heading outside that chapter other than headings 5106-5113, 5204-5212, 5306-5311, or headings of Chapters 54 and 55.

Impregnated, Coated, Covered, or Laminated Textile Fabrics

12. A change to any heading of Chapter 59 from any heading outside that chapter other than headings 5111-5113, 5208-5212, 5309-5311, 5407-5408, or 5512-5516.

Knitted or Crocheted Fabrics

13. A change to any heading of Chapter 60 from any heading outside that chapter other than headings 5106-5113, 5204-5212, 5309-5311, or headings of Chapters 54 and 55.

Apparel - Knitted or Crocheted

14. A change to any heading of Chapter 61 from any heading outside that chapter other than headings 5111-5113, 5208-5212, 5309-5311, 5407-5408, or 5512-5516; provided, that goods are both cut (or knit to shape) and sewn or otherwise assembled in the territory of either Party or both Parties.

Apparel - Not Knitted or Crocheted

15. A change to any heading of Chapter 62 from any heading outside that chapter other than headings 5111-5113, 5208-5212, 5309-5311, 5407-5408, or 5512-5516; provided, that goods are both cut and sewn in the territory of either Party or both Parties.

Other Made-Up Articles

16. A change to any heading of Chapter 63 from any heading outside that chapter other than headings 5106-5113, 5204-5212, 5306-5311, or headings of Chapters 54 and 55; provided, that goods are both cut and sewn in the territory of either Party or both Parties.

17. Notwithstanding rules 14 and 15, apparel goods provided for in Chapters 61 and 62 that are both cut and sewn in the territory of either Party or both Parties from fabric produced or obtained in a third country, and that meet other applicable conditions for preferred tariff treatment under this Agreement, shall be subject to the rate of duty provided in Annex 401.2, in the annual quantities set forth below, and shall, above those quantities for the remainder of the annual period, be subject to duty at the rates provided for most-favoured nations.

	From Canada	From the United States of America
Non-woolen apparel	50 million SYE	10.5 million SYE
Woolen apparel	6 million SYE	1.1 million SYE

SYE- Square Yard Equivalent

Trade in the apparel described in rule 17 shall be monitored by the Parties with a view to adjusting the annual quantity limitations at the request of either Party based on the ability of apparel producers to obtain supplies of particular fabrics originating within the territories of the Parties. Before January 1, 1998, the annual quantity limitations shall be renegotiated to reflect current conditions in the textile and apparel industries located within the territories of the Parties, including the ability of such apparel producers to obtain supplies of particular fabrics originating within the territories of the Parties.

18. Notwithstanding rules 4, 5, 6, 8, 11, 13 and 16, non-woolen fabric and non-woolen made-up textile articles provided for in Chapters 52-55, 58, 60 and 63 that are woven or knitted in Canada from yarn produced or obtained in a third country, and that meet other applicable conditions for preferred tariff treatment under this Agreement, shall be subject to the rate of duty provided in Annex 401.2, in the annual quantity of 30 million square yards for the period commencing on January 1, 1989 and ending on December 31, 1992, and shall, above this quantity for the remainder of the annual period, be subject to duty at the rates provided for most-favoured nations. The Parties agree to revisit the quantitative element of this agreement two years after its entry into force together with representatives of the industries in order to work out a mutually satisfactory solution, taking into account the availability of yarns in both countries.

Section XII
Footwear, Headgear, Umbrellas, Sun Umbrellas, Walking Sticks, Seatsticks, Whips, Riding Crops and Parts Thereof; Prepared Feathers and Articles Made Therewith; Artificial Flowers; Articles of Human Hair
(Ch. 64-67)

1. A change from one chapter to another.

2. A change to subheadings 6401.10-6406.10 from any other subheading outside that group; provided, that the value of materials originating in the territory of either Party or both Parties plus the direct cost of processing performed in the territory of either Party or both Parties constitute not less than 50 percent of the value of the goods when exported to the territory of the other Party.

3. A change to headings 6503-6507 from any other heading outside that group.

4. A change to headings 6601-6602 from any other heading outside that group; provided that the value of materials originating in the territory of either Party or both Parties plus the direct cost of processing performed in the territory of either Party or both Parties constitute not less than 50 percent of the value of the goods when exported to the territory of the other Party.

5. Within heading 6701, goods fabricated from feathers (such as fans, feather dusters, and feather apparel) in which feathers are the material or component that gives the fabricated goods their essential character shall be treated as a good of the country in which fabrication occurred.

6. A change to heading 6702 from any other heading.

7. A change to heading 6704 from any other heading.

Section XIII
Articles of Stone, Plaster, Cement, Asbestos, Mica, or Similar Materials
(Ch. 68-70)

1. A change from one chapter to another.

2. A change to subheading 6812.20 from any other subheading.

3. A change to subheading 6812.30-6812.40 from any other subheading outside that group.

4. A change to subheading 6812.50 from any other subheading.

5. A change to subheadings 6812.60-6812.90 from any other subheading outside that group.

6. A change to heading 6813 from any other heading.

7. A change to headings 7003-7006 from any other heading outside that group.

8. A change to headings 7007-7020 from any other heading outside that group.

9. A change to subheading 7019.20 from any other heading.

Section XIV
Natural or Cultured Pearls, Precious or Semiprecious Stones, Precious Metals, Metals Clad with Precious Metals, and Articles Thereof; Imitation Jewelry; Coin
(Ch. 71)

1. A change from one chapter to another.

2. A change to headings 7113-7118 from any other heading outside that group, except that pearls, temporarily or permanently strung but without the addition of clasps or other ornamental features of precious metals or stones, shall be treated as a good of the country in which the pearls were obtained.

Section XV
Base Metals and Articles of Base Metals
(Ch. 72-83)

1. A change from one chapter to another; provided, that goods subject to rules 9 or 22 meet the conditions set forth therein.

2. A change to headings 7206-7207 from any other heading outside that group.

3. A change to headings 7208-7216 from any other heading outside that group.

4. A change to heading 7217 from any other heading except headings 7213-7215.

5. A change to headings 7218-7222 from any other heading outside that group.

6. A change to heading 7223 from any other heading except headings 7221-7222.

7. A change to headings 7224-7228 from any other heading outside that group.

8. A change to heading 7229 from any other heading except headings 7227-7228.

9. A change to heading 7308 from any other heading, except for changes resulting from the following processes performed on angles, shapes, or sections of heading 7216:

a) drilling, punching, notching, cutting, cambering, or sweeping, whether performed individually or in combination;

b) adding attachments or weldments for composite construction;

c) adding of attachments for handling purposes;

d) adding weldments, connectors, or attachments to H-sections or I-sections; provided, that the maximum cross-sectional dimension of the weldments, connectors, or attachments is not greater than the dimension between the inner surfaces of the flanges of the H-sections or I-sections;

e) painting, galvanizing, or otherwise coating; or

f) adding a simple base plate without stiffening elements, individually or in combination with drilling, punching, notching, or cutting, to create an article suitable as a column.

10. A change to headings 7309-7326 from any other heading outside that group.

11. A change to headings 7403-7408 from any other heading outside that group; provided, with the exception of a change to subheading 7408.19, that the value of materials originating in the territory of either Party or both Parties plus the direct cost of processing performed in the territory of either Party or both Parties constitute not less than 50 percent of the value of the goods when exported to the territory of the other Party.

12. A change to heading 7409 from any other heading.

13. A change to headings 7410-7419 from any other heading outside that group; provided, that with respect to a change to heading 7413, the

value of materials originating in the territory of either Party or both Parties plus the direct cost of processing performed in the territory of either Party or both Parties constitute not less than 50 percent of the value of goods when exported to the territory of the other Party.

14. A change to heading 7505 from any other heading.

15. A change to heading 7506 from any other heading.

16. A change to United States tariff item 7506.20.50 from any other United States tariff item. This rule applies only to goods originating in the territory of Canada and imported into the territory of the United States of America.

17. A change to headings 7507-7508 from any other heading outside that group.

18. A change to headings 7604-7606 from any other heading outside that group.

19. A change to heading 7607 from any other heading.

20. A change to headings 7608-7609 from any other heading outside that group.

21. A change to headings 7610-7616 from any other heading outside that group.

22. A change to headings 7801 or 7901 from headings of other chapters; provided, that the value of materials originating in the territory of either Party or both Parties plus the direct cost of processing performed in the territory of either Party or both Parties constitute not less than 50 percent of the value of the goods when exported to the territory of the other Party.

23. A change to headings 7803-7806 from any other heading, including another heading within that group; provided, that the value of materials originating in the territory of either Party or both Parties plus the direct cost of processing performed in the territory of either Party or both Parties constitute not less than 50 percent of the value of the goods when exported to the territory of the other Party.

NOTE: see rule 22 regarding 7901.

24. A change to headings 7904-7907 from any other heading, including another heading within that group; provided, that the value of materials originating in the territory of either Party or both Parties plus the direct cost of processing performed in the territory of either Party or both Parties constitute not less than 50 percent of the value of the goods when exported to the territory of the other Party.

25. A change to headings 8003-8004 from any other heading outside that group.

26. A change to headings 8005-8007 from any other heading outside that group.

27. A change to any of the following subheadings from any other subheading: 8101.92, 8101.99, 8102.92, 8102.99, 8103.90, 8104.90, 8105.90, 8108.90, 8109.90.

28. A change to subheading 8107.90 from any other subheading; provided, that the value of materials originating in the territory of either Party or both Parties plus the direct cost of processing performed in the territory of either Party or both Parties constitute not less than 50 percent of the value of the goods when exported to the territory of the other Party.

29. A change to United States tariff item 8111.00.60 from any other United States tariff item. This rule applies only to goods originating in the territory of Canada and imported into the territory of the United States of America.

Section XVI
Machinery and Mechanical Appliances; Electrical Equipment; Parts Thereof; Sound Recorders and Reproducers, and Parts and Accessories of Such Articles (Ch. 84-85)

1. A change from one chapter to another, other than a change to heading 8544.

2. A change from one heading (other than a parts heading) to another heading, other than heading 8528 or 8529.

3. A change to heading 8407 from any other heading; provided, that the value of materials originating in the territory of either Party

or both Parties plus the direct cost of processing performed in the territory of either Party or both Parties constitute not less than 50 percent of the value of the goods when exported to the territory of the other Party

4. A change to heading 8528 or 8529 from any other heading, a change from a parts heading to a heading other than a parts heading, or a change from a parts subheading to a subheading other than a parts subheading; provided, with the exception of a change to subheading 8471.92, that the value of materials originating in the territory of either Party or both Parties plus the direct cost of processing performed in the territory of either Party or both Parties constitute not less than 50 percent of the value of the goods when exported to the territory of the other Party.

5. A change to subheadings 8471.20-8471.91 from any subheadings outside that group.

6. A change to subheadings 8516.10-8516.79 from subheading 8516.80.

7. A change to heading 8524 from any other heading. Goods subject to classification under headings 8523 or 8524 shall remain classified in those headings, whether or not they are entered with the apparatus for which they are intended.

NOTE: see rule 4 regarding headings 8528 and 8529.

8. A change to heading 8544 from any other heading; provided, that the value of materials originating in the territory of either Party or both Parties plus the direct cost of processing performed in the territory of either Party or both Parties constitute not less than 50 percent of the value of the goods when exported to the territory of the other Party.

Section XVII
Vehicles, Aircraft, Vessels and Associated Transport Equipment
(Ch. 86-89)

1. A change from one chapter to another.

2. A change to any heading of this Section (other than a heading within the groups 8701-8705 or 8901-8905) from another heading other than a parts heading.

3. A change to any heading of this Section from a parts heading; or within any heading, a change to any subheading from a parts subheading; provided, that the value of materials originating in the territory of either Party or both Parties plus the direct cost of processing performed in the territory of either Party or both Parties constitute not less than 50 percent of the value of the goods when exported to the territory of the other Party.

4. A change to headings 8701-8705 from any other heading; provided, that the value of materials originating in the territory of either Party or both Parties plus the direct cost of processing performed in the territory of either Party or both Parties constitute not less than 50 percent of the value of the goods when exported to the territory of the other Party.

5. A change to headings 8901-8905 from any other headings; provided, that the value of materials originating in the territory of either Party or both Parties plus the direct cost of processing performed in the territory of either Party or both Parties constitute not less than 50 percent of the value of the goods when exported to the territory of the other Party.

Section XVIII
Optical, Photographic, Cinematographic, Measuring, Checking, Precision, Medical or Surgical Instruments and Apparatus, Clocks and Watches; Musical Instruments; Parts and Accessories Thereof
(Ch. 90-92)

1. A change from one chapter to another.

2. A change to any heading of this Section from a parts heading, or to any subheading from a parts subheading; provided, with the exception of a change to heading 9009, that the value of materials originating in the territory of either Party of both Parties plus the direct cost of processing performed in the territory of either Party or both Parties constitute not less than 50 percent of the value of the goods when exported to the territory of the other Party.

3. A change to any heading within the group 9005-9032 from any other heading (including another heading within that group), except that a change from a parts heading shall be subject to rule 2 of this Section.

4. Notwithstanding rule 2, goods subject to classification within headings 9101-9107 shall be treated as products of the country in which the movement subject to classification under headings 9108-9110 was produced.

5. A change to headings 9108-9113 from any other heading, including another heading within that group; provided, that the value of materials originating in the territory of either Party or both Parties plus the direct cost of processing performed in the territory of either Party or both Parties constitute not less than 50 percent of the value of the goods when exported to the territory of the other Party.

Section XIX
Arms and Ammunition; Parts and Accessories Thereof
(Ch. 93)

1. A change to this chapter from any other chapter.

2. A change to any heading of this Section from a parts heading, or to any subheading from a parts subheading; provided, that the value of materials originating in the territory of either Party or both Parties plus the direct cost of processing performed in the territory of either Party or both Parties constitute not less than 50 percent of the value of the goods when exported to the territory of the other Party.

Section XX
Miscellaneous Manufactured Articles
(Ch. 94-96)

1. A change from one chapter to another, except a change to subheading 9404.90 from headings 5007, 5111-5113, 5208-5212, 5309-5311, 5407-5408, and 5512-5516.

2. A change to any heading of this Section from a parts heading, or to any subheading from a parts subheading; provided, that the value of materials originating in the territory of either Party or both Parties plus the direct cost of processing performed in the territory of either

Party or both Parties constitute not less than 50 percent of the value of the goods when exported to the territory of the other Party.

3. A change to a subheading within the group 9608.10-9608.39 from a subheading within the group 9608.91-9608.99; provided, that the value of materials originating in the territory of either Party or both Parties plus the direct cost of processing performed in the territory of either Party or both Parties constitute not less than 50 percent of the value of the goods when exported to the territory of the other Party.

4. A change to subheading 9614.20 from subheading 9614.10.

Section XXI
Works of Art, Collectors' Pieces and Antiques
(Ch. 97)

1. A change to this chapter from any other chapter.

Chapter Four: Border Measures

Key to any free-trade agreement, and required by the provisions of the GATT, is the elimination of duties and other restrictions on substantially all the trade between the parties. Implementation of the provisions of Chapter Four will achieve this requirement by providing for the removal of the tariff, tariff-related measures, quantitative restrictions and other restrictive measures applied at the border by January 1, 1998. This ten-year period is consistent with similar transition periods established in previous agreements. For example, the European Community initially provided a twelve-year period. The Tokyo Round tariff cuts were phased in over eight years.

Tariffs

The tariff has been an important but waning import policy instrument in Canada for many decades. More than 75 percent of Canada-United States trade now moves free of duty. This figure, however, fails to take account of the trade which could take place but for tariffs. High U.S. tariffs -- 15 percent and more on petrochemicals, metal alloys, clothing and many other products -- continue to pose serious barriers to the U.S. market and prevent Canadian firms from achieving the economies of scale on which increased competitiveness and employment in Canadian industry depend. In addition to high tariffs, escalating tariffs on resource-based products discourage the development of more sophisticated manufacturing in Canada. While a 1.7 cent per kilo tariff on zinc ore may not impose a significant barrier, a 19 percent tariff on zinc alloy has effectively retarded the establishment of a zinc metal fabricating industry in Canada. Additionally, the existence of Canadian tariffs on imports from the United States is often costly to Canadian consumers and producers.

This chapter eliminates all remaining tariffs over a ten-year period in order to allow companies to adjust to the new competitive circumstances. The cuts will begin January 1, 1989 and after that date, no existing tariff may be increased unless specifically provided elsewhere in the agreement (for example, in Chapter Eleven providing for temporary emergency safeguards). Tariffs will be eliminated by January 1, 1998 on the basis of three formulas:

Article 304: Definitions

For purposes of this Chapter:

direct cost of processing or **direct cost of assembling** means the costs directly incurred in, or that can reasonably be allocated to, the production of goods, including:

a) the cost of all labour, including benefits and on-the-job training, labour provided in connection with supervision, quality control, shipping, receiving, storage, packaging, management at the location of the process or assembly, and other like labour, whether provided by employees or independent contractors;
b) the cost of inspecting and testing the goods;
c) the cost of energy, fuel, dies, molds, tooling, and the depreciation and maintenance of machinery and equipment, without regard to whether they originate within the territory of a Party;
d) development, design, and engineering costs;
e) rent, mortgage interest, depreciation on buildings, property insurance premiums, maintenance, taxes and the cost of utilities for real property used in the production of the goods; and
f) royalty, licensing, or other like payments for the right to the goods;

but not including:

g) costs relating to the general expense of doing business, such as the cost of providing executive, financial, sales, advertising, marketing, accounting and legal services, and insurance;
h) brokerage charges relating to the importation and exportation of goods;
i) costs for telephone, mail and other means of communication;
j) packing costs for exporting the goods;
k) royalty payments related to a licensing agreement to distribute or sell the goods;
l) rent, mortgage interest, depreciation on buildings, property insurance premiums, maintenance, taxes and the cost of utilities for real property used by personnel charged with administrative functions; or
m) profit on the goods;

materials means goods, other than those included as part of the direct cost of processing or assembling, used or consumed in the production of other goods;

value of materials originating in the territory of either Party or both Parties means the aggregate of:

a) the price paid by the producer of an exported good for materials originating in the territory of either Party or both Parties or for materials imported from a third country used or consumed in the production of such originating materials; and
b) when not included in that price, the following costs related thereto:
    i) freight, insurance, packing and all other costs incurred in transporting any of the materials referred to in subparagraph (a) to the location of the producer;
    ii) duties, taxes and brokerage fees on such materials paid in the territory of either Party or both Parties;
    iii) the cost of waste or spoilage resulting from the use or consumption of such materials, less the value of renewable scrap or by-product; and
    iv) the value of goods and services relating to such materials determined in accordance with subparagraph 1(b) of Article 8 of the *Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade*.

value of the goods when exported to the territory of the other Party means the aggregate of:

a) the price paid by the producer for all materials, whether or not the materials originate in either Party or both Parties, and, when not included in the price paid for the materials, the following costs related thereto:
    i) freight, insurance, packing and all other costs incurred in transporting all materials to the location of the producer;
    ii) duties, taxes and brokerage fees on all materials paid in the territory of either Party or both Parties;
    iii) the cost of waste or spoilage resulting from the use or consumption of such materials, less the value of renewable scrap or by-product; and
    iv) the value of goods and services relating to all materials determined in accordance with subparagraph 1(b) of Article 8 of the *Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade;* and
b) the direct cost of processing or the direct cost of assembling the goods;

goods wholly obtained or produced in the territory of either Party or both Parties means:

a) mineral goods extracted in the territory of either Party or both Parties;
b) goods harvested in the territory of either Party or both Parties;
c) live animals born and raised in the territory of either Party or both Parties;
d) goods (fish, shellfish and other marine life) taken from the sea by vessels registered or recorded with a Party and flying its flag;
e) goods produced on board factory ships from the goods referred to in subparagraph (d) provided such factory ships are registered or recorded with that Party and fly its flag;
f) goods taken by a Party or a person of a Party from the seabed or beneath the seabed outside territorial waters, provided that Party has rights to exploit such seabed;
g) goods taken from space, provided they are obtained by a Party or a person of a Party and not processed in a third country;
h) waste and scrap derived from manufacturing operations and used goods, provided they were collected in the territory of either Party or both Parties and are fit only for the recovery of raw materials; and
i) goods produced in the territory of either Party or both Parties exclusively from goods referred to in subparagraphs (a) to (h) inclusive or from their derivatives, at any stage of production.

g) goods taken from space, provided they are obtained by a Party or a person of a Party and not processed in a third country;
h) waste and scrap derived from manufacturing operations and used goods, provided they were collected in the territory of either Party or both Parties and are fit only for the recovery of raw materials; and
i) goods produced in the territory of either Party or both Parties exclusively from goods referred to in subparagraphs (a) to (h) inclusive or from their derivatives, at any stage of production.